FIXED INCOME Q&A

Jim Bernard, CFA
Managing Director, Fixed Income
December 2015

Q. How would you characterize the current state and outlook of the U.S. economy?

A. The domestic economy continues to move forward at a historically modest pace of just under 3% YOY growth. While job growth continues at a reasonable rate and the unemployment rate continues to fall (now at 5%), the historically low rate of overall employment has contributed to holding down increases in wage growth leading to modest consumption growth and therefore an overall modest economic growth trend. Finally, as we are approaching 7 years since the last recession an eventual end to this economic cycle must also be considered at some point in the future.

Q. The Federal Reserve seems poised to raise interest rates sooner rather than later. With that in mind, can you please provide a glimpse into the FED's decision making process and the concept of the "dual mandate"?

A. The FED has been reluctant to date to raise rates because of concerns about the forecasted weakness in economic activity here and around the world. In addition, previously mentioned slow wage growth trends also concern the FED. We do believe that current economic growth levels are adequate enough to begin raising rates in the near future. However the pace over the next few years will be measured. The dual mandate of promoting domestic economic growth with price stability has been a challenge for the FED as general price stability has not been a significant problem in recent years, but maintaining consistent economic growth has been challenging during this economic cycle.

Q. Much has been made of the timing of the first FED rate increase, but perhaps more important will be the slope of future increases. What is your view on the slope of future increases and why is this important to investors of all asset classes?

A. We remain in line with the consensus view that during the next few years we will see a modest pace of rate increases, averaging 50-75 bp's per year. If the current economic cycle were to end in the next few years these increases could end or even be reversed. The future slope of the yield curve is of greater uncertainty as long rates remain low, based on modest inflationary trends. We continue to expect an upwardly sloping yield curve with a slope to the curve very similar to what we are currently experiencing.

Q. How has increased regulation such as Dodd Frank impacted the bond markets and what does this mean to the average fixed income investor?

A. Increased regulations, and more importantly, higher capital requirements, have in general reduced the appeal of trading activity for many capital market groups. As such, lower bond inventories in general have been a major concern for liquidity in the various bond markets, especially if weaker (higher interest rates) markets were to occur. We believe the primary concern for this potential lower liquidity market rests with the larger bond dealers and bond management firms who may find it difficult to get competitive bids when and if needed in a bond market sell-off. The impact on individual holders of bonds should be minimal with potentially modestly wider bid to offer spreads.

Q. Where do you see value in the taxable bond market right now?

A. Unfortunately most of the investment grade bond sectors are trading at or near historically tight credit spreads. Sectors such as mortgage backed securities (agency backed) are still seeing significant government buying activity holding spreads at low levels. Lower investment grade corporate issues show some modestly attractive value as balance sheets remain in solid shape while spreads are at reasonable levels. When available we also see decent value in intermediate term callable agencies trading at a reasonable discount to their face values.

Q. How does the municipal bond landscape look from your vantage point? Have the credit issues of Detroit, Chicago and Puerto Rico impacted the overall municipal bond market in a material way?

A. Municipal credits in general have had a very solid year so far with little negative reaction to the distressed stories of Detroit, Chicago/Illinois, Puerto Rico, etc. Certain lower rated, distressed credits have seen negative price action based on these distressed stories but, in general, most credits have not suffered any negative price action unless directly related to these distressed credits. Overall we continue to see very good relative value in many municipal credits with the caveat that one has to be very selective in picking credits to buy, even among investment grade names.

Thank you, Jim. If you have other questions for Jim please feel free to contact him at 216-825-4000 jb@ancora.net

Jim Bernard, CFA, is the Managing Director, Fixed Income at Ancora Advisors LLC a SEC Registered Investment Advisor. He is also a Registered Representative and Registered Principal of Safeguard Securities, Inc. (Member, FINRA/SIPC)